

This letter discusses the graphic arts exemption from sales tax. 86 Ill. Adm. Code 130.325. It also discusses the Service Occupation Tax. (This is a GIL.)

June 18, 2003

Dear Xxxxx:

This letter is in response to your letter dated January 19, 2003. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

My client is a lithographer in the graphic arts business. Do they incur use tax liability on the film, proofing material and plates used in their graphic arts business?

In addition, they are considering purchasing a press. I understand that they do not incur Retailer's Occupation tax on the business cards, letterhead and stationary they print and sell to their customers. Do they incur use tax liability on the paper, ink, plates, film and envelopes they purchase from their vendors?

For your information, we have enclosed a copy of 86 Ill. Adm. Code 130.325, which is the Department's regulation for the Graphic Arts Machinery and Equipment exemption. The Graphic Arts Machinery and Equipment exemption extends to machinery and equipment, including repair and replacement parts, both new and used and including that manufactured on special order to be used primarily (over 50% of the time) in graphic arts production. The exemption extends to purchases by lessors who will lease the property for use primarily in graphic arts production.

Under Section 2-30 of the Retailers' Occupation Tax Act, 35 ILCS 120/2-30, the definition of "graphic arts production" means "printing, including ink jet printing, by one or more of the processes described in Groups 323110 through 323122 of Subsector 323, Groups 511110 through 511199 of Subsector 511, and Group 512230 of Subsector 512 of the North American Industry Classification System published by the U.S. Office of Management and Budget, 1997 edition. Graphic arts production does not include (i) the transfer of images onto paper or other tangible personal property by means of photocopying or (ii) final printed products in electronic or audio form, including the production of software or audio-books." Group 323115 of the North American Industry Classification System includes digital printing processes.

Section 130.325(b)(1)(C) provides that "[t]he exemption applies to machinery and equipment used in graphic arts production processes, as those processes are described in the NAICS. While the NAICS subsectors referenced in subsection (b)(1)(A) describe types of graphic arts establishments

that typically engage in graphic arts production, the exemption is not limited to qualifying machinery and equipment used by the establishments described in the NAICS, but rather, to qualifying machinery and equipment used in the printing processes described in the NAICS (for example, lithography, gravure, flexography, screen printing, quick printing, digital printing and trade services such as prepress and binding and finishing services)."

The summary for Group 323115 provides that "[t]his U.S. industry comprises establishments primarily engaged in printing graphical materials using digital printing equipment. Establishments known as digital printers typically provide sophisticated prepress services including using scanners to input images and computers to manipulate and format the graphic images prior to printing." The Department's regulation at Section 130.325(b)(1)(D) provides that "[t]he exemption includes printing by methods of engraving, letterpress, lithography, gravure, flexography, screen, quick, and digital printing. Section 130.325(b)(1)(E) defines "digital printing" as "the printing of graphical text or images by a process utilizing digital technology, as provided in subsection (b)(4) of this Section." Subsection (b)(4) describes activities that will generally be considered graphic arts production.

Subsection (b)(4)(A) describes prepress and preliminary processes. Subsection (b)(4)(A) describes prepress and preliminary processes. Under this subsection "[p]repress or preliminary processes include the steps required to transform an original into a state that is ready for reproduction printing. Prepress or preliminary processes include typesetting, film production, color separation, final photocomposition (e.g., image assembly and imposition (stripping)), and platemaking. Prepress or preliminary processes include the manipulation of images or text in preparation for printing for the purpose of conforming those images to the specific requirements of the printing process being utilized. For example, the images must be conformed for a specific signature layout and formatted to a specific paper size. In addition, colors must be calibrated to the specific type of paper or printing process utilized, so that they conform to customer specifications." Please note that "preliminary processes do not, however, include the creation or artistic enhancement of images that will later be reproduced in printed form by a graphic arts process. For example, the creation of an advertisement pursuant to customer direction, or enhancement of a photograph received from a customer by adding a border, text or rearranging the placement of images in the photograph, is not the performance of a qualifying prepress or preliminary process."

With regard to prepress activities, subsection (b)(4)(A)(ii) provides that "[c]omputers that qualify include computers used primarily to receive, store and manipulate images to conform them to the requirements of a specific printing process that will later be performed. Computers used in connection with what is commonly referred to as 'digital photography' will qualify if used primarily to format the graphic image that will be printed (e.g., used to format the size and layout of images to be printed.) If such computers are primarily used, however, to apply background colors, borders or other artistic enhancements, or to view and select particular digital images to be printed, they will not qualify for the exemption." Subsection (b)(4)(A)(iv) provides that "[s]ervers used primarily to transfer images and text to qualifying equipment qualify, but do not qualify if used primarily in a non-exempt activity (for example, servers used to maintain an in-house email system)." Subsection (b)(4)(A)(v) provides that "[s]canners used primarily to input previously created images or text that will be reproduced by a graphic arts process qualify for the exemption."

Subsection (b)(4)(B) discusses the transfer of images or text from computers, plates, cylinders or blankets to paper or other stock to be printed. This process begins when paper is introduced on the press. "Examples of qualifying equipment used in this activity include printing plates, printing presses, blankets and rollers, automatic blanket washers, scorers and dies, folders, punchers, stackers, strappers used in the pressroom for signatures, dryers, chillers and cooling towers. Laser or ink jet printers used to print on paper or other stock are also included in this exemption."

Subsection (b)(4)(C) discusses activities involving the binding, collating or finishing of the graphic arts product. "Equipment used in these activities includes, for instance, binders, packers, gatherers, joggers, trimmers, selectronic equipment, blow-in card feeders, inserters, stitchers, gluers, spiral binders, addressing machines, labelers and ink-jet printers."

Subsection (b)(7) provides that "[t]he statute provides for the purchase of graphic arts machinery and equipment by lessors who will lease that machinery and equipment for use in graphic arts production. Therefore, if the purchaser of the machinery or equipment leases the machinery and equipment to a lessee who uses it in an exempt manner, the sale to the purchaser-lessor will be exempt from tax. A supplier may exclude these sales from his taxable gross receipts provided that the purchaser-lessor provides to him a properly completed exemption certificate and the information contained in the certificate would support an exemption if the sale were made directly to the lessee. Should a purchaser-lessor subsequently lease the machinery or equipment to a lessee who does not use it in an exempt manner that would qualify directly for the exemption, the purchaser-lessor will become liable for the tax from which he was previously exempted."

Subsection (b)(8) provides that "[p]urchasers wishing to claim the exemption must certify to their suppliers that the machinery and equipment will be used primarily for graphic arts production. Retailers must maintain the certificates in their books and records." "The certificate must include the seller's name and address, the purchaser's name and address and a statement that the property purchased will be used primarily in graphic arts production." "If a graphic arts producer or lessor purchases at retail from a vendor who is not registered to collect Illinois Use Tax, the purchaser must maintain a copy of the certification in his records to support the deduction taken on the return." The Department's form ST-587, Equipment Exemption Certificate may be used for claiming the graphic arts machinery and equipment exemption.

As a general rule, when a product is an item of general utility and serves substantially the same function as a stock or standard item, the product will be subject to Retailers' Occupation Tax liability when sold at retail. See the enclosed copy of 86 Ill. Adm. Code 130.2000. Items which serve substantially the same function are those which, when produced on special order, could be sold as produced to someone other than the original purchaser at substantially the same price. Calendars are typically such items of general utility. Gift tags may also fall into this category.

When custom order items are sold, Retailers' Occupation Tax does not apply. For example, as indicated in 86 Ill. Adm. Code 130.1995(b), enclosed, personalized business calling cards and letterheads are not subject to Retailers' Occupation Tax when sold. However, sales of custom order items are subject to Service Occupation Tax liability.

For your general information, we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax. Servicemen may calculate their tax base in one of four ways: 1. Separately stated selling price; 2. 50% of serviceman's entire bill; 3. SOT on his cost price if he is a registered de minimis serviceman; or, 4. Use Tax on his cost price if he is an unregistered de minimis serviceman. Please see the enclosed copy of 86 Ill. Adm. Code 140.101, the Basis and Rate of the Service Occupation Tax.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax

base be less than the servicemen's cost price of the tangible personal property transferred. Such servicemen collect a corresponding amount of Service Use Tax from their customers.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations. Such servicemen collect a corresponding amount of Service Use Tax from their customers.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers.

Having said all this, please note that SB0842 has been passed by the Illinois General Assembly and is waiting to be signed by the Governor. This bill repeals the graphic arts exemption from sales tax effective July 1, 2003.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

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Associate Counsel

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